



**Final Minutes  
Endowment Fund Investment Board (EFIB) Regular Meeting  
August 25, 2004**

The regular meeting of the Endowment Fund Investment Board was held on Wednesday, August 25, 2004. Chairman Dean Buffington called the meeting to order at 9:07 a.m. and recognized that a quorum was present.

**Members Present:**

M. Dean Buffington  
Representative William W. Deal  
Gavin M. Gee  
Thomas F. Kealey  
Senator Brad J. Little  
Dr. Richard L. Miller  
William D. Mitchell  
R. John Taylor  
Parker G. Woodall

**Staff Present:**

Matthew J. Haertzen  
Connie M. Eshelman  
Andrew M. Potter  
Angela R. Zirschky

**Members Absent:**

None

**Guests:**

Roland Gammil, Judges' Retirement Fund  
Corrie Keller, Judges' Retirement Fund  
Bob Maynard, Public Employees' Retirement System  
Eric Miecek, RBC Dain Rauscher  
John Pickett, RBC Dain Rauscher  
Bill Reese, Judges' Retirement Fund  
Larry Schlicht, Division of Financial Management  
Michelle Soderlund, Pinnacle Pension Services

**1. Minutes of the May 11, 2004 Regular Meeting: Approved**

A motion was made by Representative William Deal, second by Gavin Gee to approve the May 11, 2004 meeting minutes. The motion carried unanimously.

**2. State Insurance Fund (SIF) Reports: *Presented by Matthew Haertzen, Investment Manager, EFIB and John Pickett, RBC Dain Rauscher***

John Pickett outlined the results of the 2nd quarter 2004 market returns and the one-year returns as of June 30, 2004. Additionally, Mr. Pickett reported that the portfolio is inline with allocation targets. A TIPS fund was added last quarter to the portfolio and will be increased from the present 2.6% to 10% of the total portfolio by reducing the Aggregate and Intermediate Government/Corporate portions of the portfolio.

### **Manager Review**

Mr. Pickett reported that small cap value manager Barrow Hanley, Mewhinney, and Strauss and mid cap value manager Oppenheimer Capital Management both performed well during the 2<sup>nd</sup> quarter of 2004 .

### **3. Judges' Retirement Fund (JRF) Reports: *Presented by Matthew Haertzen, Investment Manager, EFIB and John Pickett, RBC Dain Rauscher***

RBC Dain Rauscher was recently hired by the Judges' Retirement Fund, and Mr. Pickett reported that the Fund is now being reallocated. As of June 30, 2004, the portfolio was in transition to new policy. Since then, the moving process has begun, and the Fund is close to the proper allocation. The fixed income portion of the portfolio is currently actively managed.

Mr. Pickett reviewed several new performance reports that will be part of their new standard reporting format. These reports look at the performance of the Fund from a long-term historical perspective. Although the Fund does not have a good historical report card, Mr. Pickett reported that the Fund will be restructured to ensure a more predictable portfolio.

### **Actuarial Valuation: *Presented by Michelle Soderlund, President, Pinnacle Pension Services***

Ms. Soderlund gave the Board an overview of the JRF and reported that the plan is funded through various contributions, those being member contributions, State contributions, and the special fees collected under Section 1.2003, Idaho Code. Contributions from civil filing fees are increased periodically to maintain the financing of the Fund.

Currently, the future investment earnings of the assets are assumed to grow at an annual rate of 7.5%. The following are the estimated actual average rates of return over various periods of time calculated by Bill Reese. With this data, Ms. Soderlund reported that she is comfortable with a 7.5% rate of return.

<u>Number of Years</u>	<u>Average Rate of Return After Expenses</u>
25 .....	9.96%
20 .....	10.19%
15 .....	9.51%
10 .....	8.19%

Additionally, Ms. Soderlund reported that the unfunded actuarial liability as of June 30, 2003 was approximately \$13,095,000 or 22% and as such, the present level of contributions to the Fund are insufficient to finance the present benefit structure.

The EFIB is presently monitoring the situation and will await the completion of the June 30, 2004 actuarial valuation before recommending any further action. This actuarial study will be available at the next Board meeting and will be closely analyzed to determine the trend of the funding status for the plan.

#### **4. Endowment Fund**

##### **A. Performance and Update: *Presented by Matthew Haertzen, Investment Manager, EFIB and John Pickett, RBC Dain Rauscher***

Mr. Pickett reported that the Fund saw good returns as of June 30, 2004 and the portfolio is inline with policy. It was also noted that the Endowment Fund had an exceptional fiscal year return, ranking in the 17<sup>th</sup> percentile of balanced funds.

##### **Manager Review:**

Mr. Pickett reported that Marvin and Palmer have been placed on the watch list; however, he is not overly concerned with their performance at this point and is not putting a timeline on their watch. Mr. Pickett cited that Marvin and Palmer follows an investment theme, heavily weighted in a particular sector which would explain underperformance during a non-thematic market, with frequent rotation in leadership between sectors.

##### **B. Staff Reports: *Presented by Matthew Haertzen, Investment Manager, EFIB***

Staff reports were as reported with no comments or discussion.

##### **C. Quarterly Manager Reviews: *Presented by Connie Eshelman, Investment Officer, EFIB***

Ms. Eshelman reported that conference calls are now being conducted with four different managers each quarter. All Board members are welcome to participate in the calls and should contact Connie Eshelman or Matt Haertzen for scheduling. Three managers were reviewed last quarter, Artisan Partners, LLC; Mastrapasqua and Associates Management; and Nicholas Applegate Capital Management. No negative findings were reported. The Board commented that they enjoyed the new one page manager review summary and would like to see them continued.

##### **D. Capitol Permanent Fund Update: *Presented by Matthew Haertzen, Investment Manager, EFIB***

Mr. Haertzen reported that legislation was passed during the 2004 session allowing the Capitol Permanent Fund to become part of the Endowment Fund. On July 1, 2004, the Capitol Permanent Fund was moved into the Endowment Fund, making the \$6 million dollar Capitol Permanent Fund one of the EFIB beneficiaries. Mr. Haertzen informed the EFIB that each May, the EFIB will need to set the spending policy for the Fund.

##### **E. Budget Review FY06: Approved - *Presented by Matthew Haertzen, Investment Manager, EFIB***

Mr. Haertzen reported that the Endowment Fund budget closed fiscal year 2005 at 14% below budget. The recommended budget for fiscal year 2006 was as reported with a total budget request of \$574,800 versus the fiscal year 2005 total budget request of \$550,200. An additional \$2,500 was added to the capital portion of the 2006 request for server upgrades.

Other costs added to the 2006 budget request included normal inflation and factoring in personnel costs for a 27<sup>th</sup> pay period. No other costs were added to the budget.

A motion was made by Representative William Deal, second by Parker Woodall to approve the EFIB budget as presented. The motion carried unanimously.

**F. Worldcom Update: *Presented by Matthew Haertzen, Investment Manager, EFIB***

Mr. Haertzen reported that per the Attorney General's Office, the EFIB will no longer proceed with an individual suit but will participate in the class action suit.

**G. May Manager Summit Review: *Presented by Matthew Haertzen, Investment Manager, EFIB***

Chairman Dean Buffington opened the floor for comments regarding the May Manager Summit. Senator Brad Little suggested 1) hosting a session that would present what is state-of-the-art for other endowment funds 2) spend less time allowing the managers to present their markets, and 3) focus on best management practices, including peer comparisons. No other comments or suggestions were entertained.

**Investment Plans:**

**1. Lehman Aggregate versus Intermediate Aggregate: *Presented by Connie Eshelman, Investment Officer, EFIB***

Ms. Eshelman reported that per consensus from the manager summit, fixed income is currently the largest risk to the Endowment Fund portfolio. To offset this risk, three options were considered, those being: 1) shifting the fixed income exposure from the Lehman Aggregate to Lehman Intermediate Aggregate 2) Adding investments to collateralized obligations 3) Initiating a pilot hedge fund investment program.

As a result, Ms. Eshelman conducted a study on the Lehman Aggregate versus the Intermediate Aggregate. The return rates of both indices from May 1976 to May 2004 were evaluated showing a similar long-term rate of return. However, the intermediate index earned this return with less risk. Ms. Eshelman also studied the last three tightening cycles of the Federal Reserve and discovered that the Lehman Aggregate outperformed the Intermediate Aggregate in most months during the cycles. With these findings, Ms. Eshelman recommended to the board that short-term, it would be prudent for the Endowment Fund to remain in the Lehman Aggregate Bond Fund.

Long-term plans include monitoring the fed tightening cycle and conducting a follow-up review in one year to reconsider a possible change into the Intermediate Aggregate Bond Fund at that time.

**2. Collateralized Debt: *Presented by John Pickett, RBC Dain Rauscher***

Mr. Pickett reported on the possibility of adding senior collateralized securities as an alternative to the fixed income portion of the portfolio. The collateralized debt would add value from a diversification perspective and would also help lower the risk in the portfolio during periods of rising rates. Mr. Pickett explained that the securities would be original loans from large commercial banks for their corporate customers. These loans would usually be below investment grade companies unable to finance operations via a public debt offering. The securities would fall within the 30% fixed income portion of the portfolio and a manager would be hired.

The Board recommended that Mr. Pickett and Mr. Haertzen present the following at the next Regular Board Meeting:

1. What part of the 30% fixed income portion of the portfolio would be allocated to the collateralized securities

2. What it would do to the portfolio during a volatile market
3. What would be the expected return and risk characteristics of the investment

**3. Hedge Funds: Presented by Matthew Haertzen, Investment Manager, EFIB**

Mr. Haertzen reported on a pilot hedge fund investment program which would utilize low-risk strategies with low correlation to traditional equity and fixed income asset classes to provide added diversification to the portfolio.

The Board recommended that Mr. Haertzen address the following issues at the next board meeting:

1. Targeted final allocation to absolute return strategies
2. Time commitment required to train the EFIB and Land Board about the types of investments.
3. Internal costs, and
4. Risk and return characteristics of the investments.

**5. Audit: Approved - Presented by Jae Hallett, Partner, Balukoff, Lindstrom & Co., PA and Parker Woodall, Audit Committee Chairman, EFIB**

Mr. Woodall reported that the EFIB audit committee (Parker Woodall, Senator Brad Little, and William Mitchell) reviewed the Endowment Fund and Capitol Permanent Fund audit in detail and visited privately with Balukoff, Lindstrom & Co., PA via teleconference to discuss the audit.

**Endowment Fund Audit**

Two items identified in last year's audit were resolved, those being a reallocation of market value between the Earnings Reserve and Corpus, and the movement of \$1.5 million in cash held on the State Controller's system back to the Endowment Fund.

Balukoff, Lindstrom & Co., PA noted three areas for improvement for fiscal year 2005:

1. Regular and detailed reconciliation of expenses between general ledger and STARS systems.
2. Regular and detailed reconciliation of general ledger fund balances with custodial statements, not just with monthly activity.
3. Begin accruing investment manager expenses at fiscal year-end (approximately \$400,000)

**Capitol Permanent Fund Audit**

No findings were noted on the Capitol Permanent Fund Audit.

In conclusion, Mr. Woodall reported that the audit committee recommended acceptance of both the Endowment Fund and the Capitol Permanent Fund audit reports.

The motion was made by Parker Woodall, second by William Mitchell to accept the audit reports as presented. The motion carried unanimously.

**6. Next Meeting Date:** The next Regular Endowment Fund Investment Board Meeting will be held Tuesday, November 09, 2004 to meet jointly with the Land Board.

There being no further business to come before the Board, the motion was made by Gavin Gee, second by William Mitchell to adjourn the meeting at 11:48 p.m. The motion carried unanimously.